

VZCZCXRO0248  
RR RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV RUEHSR  
DE RUEHGV #0220/01 0750823  
ZNR UUUUU ZZH  
R 160823Z MAR 09  
FM USMISSION GENEVA  
TO RUEHC/SECSTATE WASHDC 8130  
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE  
RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RHEHNSC/NATIONAL SECURITY COUNCIL WASHINGTON DC  
RUCNDT/USMISSION USUN NEW YORK 2981  
RUEHBS/USEU BRUSSELS

UNCLAS SECTION 01 OF 03 GENEVA 000220

SIPDIS

STATE FOR IO/EDA and EEB/OMA  
USUN for JLAWRENCE

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [EINV](#) [UNGA](#) [ECOSOC](#)

SUBJECT: Financial Crisis - Looking for the Magic Bullet

¶1. SUMMARY: The global economic downturn was the focus of several meetings in Geneva March 9-12. The UN Commission on Financial Reforms (the Stiglitz Commission) slammed U.S. regulatory failures, and promoted greater institutional power and money for lesser developed countries. The UN Conference on Trade and Development released a report focusing on the triple crises in financial, commodity, and currency markets. The UN apparently has grand ambitions leading up to a June Ministerial, as outlined in detail below, but we suggest the USG focus on garnering multilateral support for practical ways countries can pool their resources to lessen the impact of the economic downturn. END SUMMARY.

-----  
UN Commission on Financial Reforms  
-----

¶2. The commission of experts of the President of the United Nations General Assembly on reforms of the international monetary and financial system held its second, closed-door session in Geneva March 10-11. Joseph Stiglitz, Professor at Columbia University and Nobel Prize laureate, who leads the Commission, presented some of its key findings to member states at both the UN Conference on Trade and Development (UNCTAD) and the International Labor Organization (ILO) on March 12, 2009. He argued that the United States and the United Kingdom are largely responsible for the world financial crisis, mainly due to their failure to regulate risk properly. Nevertheless, the crisis is harming all countries, so all countries, not just the G20, should have a voice in its resolution.

Causes of the crisis  
-----

¶4. Stiglitz attributed the crisis to three underlying problems. First, markets were built on a theory of market fundamentalism, namely that unfettered markets work perfectly and are self-correcting, and this theory failed in practice. Second, management of the Asian financial crisis taught developing countries that they should create large foreign currency reserves. Countries built huge reserves, but this dampened aggregate demand and aggravated global imbalances. Third, in the absence of sufficient global demand, central banks pursued loose monetary policies, allowing debt accumulation by entities that had no capacity to repay that debt. In response to the ensuing global financial crisis, the world needs a global economic stimulus package, and institutional and regulatory reforms.

Global Stimulus Package and Financial Reforms  
-----

¶5. Stiglitz proposed a new issuance of Special Drawing Rights (SDRs) and the auctioning of carbon permits and other global goods as a source of new funds for global economic stimulus packages. He stated that one percent of all developed country stimulus packages should be allocated to developing countries to stimulate their much smaller economies. There should be no conditionality on that stimulus money, because conditionality has forced countries to

pursue pro-cyclical policies and lose sovereignty. Stiglitz added that there should be "a new international lending facility that could deliver aid in a way that is better for donors and recipients," but did not elaborate further.

¶16. Stiglitz also encouraged member states to address competition policy at the global level to resolve the problem that some banks supposedly have become too big to fail. He said there should be a "financial product safety commission" that could provide guidance about the efficacy, use and risk of financial instruments. There also should be some global financial regulation, to avoid regulatory arbitrage.

¶17. Stiglitz advocated the establishment of a new global reserve system. He said small changes in voting rights in the Bretton Woods organizations (the international financial institutions, IFIs, such as the IMF And World Bank) will not make a difference; what is needed are big changes in voting rights and the way Executive Directors are chosen. The world needs better global economic and financial surveillance, and central banks need a broad reform of their policies because central bankers need to address long term growth not just inflation.

¶18. Stiglitz encouraged the issuance of GDP-linked bonds by developing countries to mitigate risk. He said this global financial crisis will be followed by a sovereign debt crisis and that we need to agree upon a sovereign debt restructuring mechanism now to deal with it.

#### Protectionism and Moral Hazard

¶19. Stiglitz warned that the current stimulus policies can be

GENEVA 00000220 002 OF 003

protectionist, singling out the United States and its cosmetically amended "Buy America" provisions. Stiglitz opined that the "Buy America" provisions will harm poor developing countries. Stiglitz criticized U.S. and European subsidies, saying they create an uneven playing field that is insurmountable for the developing countries. Stiglitz suggested a framework of global regulation to curb these subsidies and criticized the Doha Development Round as falling short. Stiglitz also recommended that the developed countries open their markets further to the least developed countries (LDCs), and particularly extend the "everything but arms" tariff relief to more countries.

¶10. Stiglitz expressed deep concern about the impact of the US and European bail-out packages in terms of moral hazard. He said that the knowledge companies have that they may be bailed-out changes their perception of risk. "The level playing field has been destroyed. We need to compensate developing countries for the huge advantage bail-outs provided to developed countries."

#### Reforms and New Institutions

¶11. Stiglitz suggested the establishment of several new institutions and mechanisms: a financial product safety commission; a new international lending institution; a sovereign debt restructuring mechanism; and a Global Economic Coordination Council (GECC). Stiglitz said the Commission was still debating the role of the GECC and whether it should be created as a global regulator, promulgating rules, or as a coordinator, overseeing rules which would not touch on sovereignty issues. He explained that government regulations do not operate across borders, but we need an entity that looks at competition and regulations globally to avoid regulatory arbitrage across countries by companies and to address the challenges posed by this crisis. Stiglitz said along with regulatory coordination, the GECC could take the IMF's surveillance function. According to Stiglitz a lender, like the IMF, has a conflict of interest when it conducts surveillance since it looks at the world from the standpoint of repayment, so will have an inherent bias to promote pro-cyclical policies, while what we need are counter-cyclical policies.

-----  
Next Steps at the UN

-----  
¶12. After Stiglitz presented his oral report, Paul Oquist, Senior Advisor from the UNGA President's office, stated that the Commission's written report, along with consultations between the UNGA President and the G-20, G-7 and G-8, will feed into an outcome document drafted by the UN Department of Economic and Social Affairs (DESA) that delegates will negotiate in New York, starting April 12, leading to a Ministerial meeting June 1 and 2 to deal with contentious issues, and then a heads of state and government meeting June 3 and 4. He provided the following time line for the Commission's work and its usage. He noted the schedule was compressed because some countries are running out of reserves and need help now. (COMMENT: Oquist presented the schedule and actions to occur as accepted facts. However, after the meeting, several delegates told us they were unaware of member state agreement on this schedule or plan. END COMMENT).

-- March 20: UNGA president will have received input from the Commission, G-20, G-7 and G-8.

-- March 25: UN agencies and regional commissions will provide their view on the financial crisis.

-- March 26 and 27: the Commission chaired by Stiglitz will present its conclusions and then the four working groups under the Commission will present their findings and have a dialogue with member states.

-- Early April: the UNGA President with DESA will produce a report on the financial crisis.

-- April 13: intergovernmental negotiations on a proposed draft outcome document will begin in New York.

-- June 1-2: Ministerial meeting in NY to deal with contentious issues.

-- June 3-4: Heads of State and Government meeting in NYC.

¶13. Oquist put the Stiglitz Commission, and plans for negotiating a document on the financial crisis at the UN, in a broader context. He said the Monterrey Consensus was a breakthrough, since it was the first time that the UN had a financial and economic-focused meeting

GENEVA 00000220 003 OF 003

with a Ministerial Declaration. Up to that point, conventional wisdom had been that only the IFIs and US Treasury had expertise to deal with financial and economic issues. Monterrey changed that attitude. Now, he opined, the Stiglitz Commission is another breakthrough for the UN to give further voice to the world community on these issues.

¶14. Oquist stated emphatically that the final solutions to the global financial crisis need to come to the UN for approval as a matter of legality. The G-7 and G-8 are totally ad-hoc and have no basis in international law. International solutions affect everyone, so everyone should have a voice in them for them to be legitimate. Oquist concluded that trillions are being spent to reinstate credibility in the global financial system, but to have credibility we must have equality and justice where everyone feels their interests are represented.

-----  
UNCTAD takes a stand  
-----

¶15. On March 9, in part as input for the Stiglitz Commission, the UNCTAD Secretariat produced a paper on the economic crisis, identifying crises in the financial, commodity and currency markets.

In his paper, Dr. Heiner Flassbeck, Director, Division on Globalization and Development Strategies at UNCTAD, suggested three possible solutions to the economic crisis. The first suggestion was a regional currency system with 'planets' and 'satellites,' and a managed floating exchange rate with the satellite countries' currencies tied to the planets' currencies. Second, Flassbeck

proposed establishment of a body for global oversight of financial institutions, to identify and restrict usage of financial instruments that do not have any social benefits. The final solution Flassbeck offered was debt inflation by developed countries, to compensate for insufficient private demand.

¶16. In a March 10-11 UNCTAD Experts' meeting on Gender and Trade, in the context of the financial crisis the USDel suggested UNCTAD should monitor trade data to identify which sectors in which countries were hardest hit by the global financial crisis, and to apply gender analysis to those hardest hit sectors to determine if women and men were impacted differently, and finally to inform member states of that research and analysis on a timely basis, so states could develop gender-aware policy responses. This suggestion was supported by delegates from all regions and NGOs, who all opined it would be a practical and constructive way to help limit the negative impact of the financial crisis on women and children.

-----  
COMMENT  
-----

¶17. In our view, the various reports accurately report the causes of the economic downturn and the interrelationship between the financial, commodity, and currency crises. Some dispute remains regarding proposed solutions. The real question is how to get past economic modeling for ideological purposes, and put into practice the widely-accepted view that countries need to act in concert to deal with the economic downturn. For example, the U.S. Treasury recently announced it is developing a method for the USG to join with private investors to begin buying the mortgage-backed securities and other complex financial instruments whose resumed trading is so important to the stability of the financial system. To address the multilateral dimension of this economic problem in concrete terms, the Department might wish to explore the possibility of convincing other governments to contribute to that effort to attack the financial crisis at its roots. Ultimately, we will need to find ways to deal with overly broad ideas about reforming the world's financial architecture, as proposed by Stiglitz and others, and develop practical multilateral solutions to global market instability.  
STORELLA#